SUPREME COURT, U. S.

No. 70-79

In the Supreme Court of the United States

October Term, 1971

RELIANCE ELECTRIC COMPANY,

Petitioner,

vs.

EMERSON ELECTRIC COMPANY,

Respondent.

On Writ of Certiorari To The United States Court of Appeals For The Eighth Circuit

BRIEF FOR RESPONDENT

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BRIEF FOR RESPONDENT

STATUTE INVOLVED

The portions of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), relevant here are:

> Section 16(b). For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner [the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title]*, direc-

* The bracketed words are from Section 16(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(a).

> tor, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . . This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

QUESTION PRESENTED

When the beneficial owner of more than 10% of a company's stock, within six months of the purchase of that stock (a) deliberately sells enough of the stock to reduce his holdings to less than 10% in order to avoid possible "short swing" profit liability by reason of an involuntary "sale" resulting from a forthcoming merger which he had opposed and (b) thereafter, in a separate and unrelated transaction prior to the merger, sells the balance of his stock to the issuer company with the approval of the company's merger partner, is he liable under the "short swing" profit provision of § 16(b) of the Securities Exchange Act of 1934 for the second sale in view of the exemption provision of § 16(b), which expressly states that §16(b) "shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale"?

STATEMENT OF THE CASE

Some of the facts of this case have been set forth in the briefs of petitioner Reliance Electric Company (hereinafter "Reliance") and the Securities and Exchange Commission (hereinafter "SEC") and will not be restated. However, certain relevant facts omitted from those statements need to be presented.

The events leading up to this case began on May 22, 1967, when Emerson Electric Company, St. Louis, Missouri, (hereinafter "Emerson") published a tender offer for the common stock of Dodge Manufacturing Company, Mishawaka, Indiana, (hereinafter "Dodge") (A. 19-23). Dodge was a publicly owned corporation whose shares were listed on the New York Stock Exchange. Immediately upon publication of the tender offer, the Dodge board voted to oppose it. Communications were immediately transmitted to all Dodge shareholders urging them to reject the tender offer (A. 74-77). On May 25, in further pursuit of its vigorous efforts to foreclose Emerson, Dodge announced it had entered into an agreement in principle to merge into Reliance. It communicated with its shareholders urging them to approve the merger and reject Emerson's tender (A. 78-79).

Furthermore, on May 27, Dodge filed suit in the United States District Court for the Northern District of Indiana, seeking an injunction prohibiting Emerson from further pursuing its tender offer or accepting any tenders. Dodge charged Emerson, *inter alia*, with misuse of allegedly confidential insider information acquired from Dodge (A. 81-90). Following an extended hearing, the District Court on June 8 denied Dodge's request for a preliminary injunction (A. 61, 91). The court specifically found that Emerson had acquired no confidential or other insider in-

formation from or about Dodge and that all its knowledge concerning Dodge had been gleaned from publicly available sources (A. 97).

Dodge's opposition was successful in that only 152,282 shares (13.2% of Dodge's outstanding shares) were tendered. Emerson's tender offer was consummated on June 16, 1967, at which time Emerson purchased all tendered shares. Emerson paid $63.00 per share—$18.25 more per share than the price at which Dodge stock was traded on the New York Stock Exchange on the last trading day before Emerson announced its tender offer (A. 15, 19, 70).

In opposition to the Reliance merger offer, Emerson determined to make a counter proposal to Dodge shareholders that Dodge be merged into Emerson (A. 102-05). The Dodge board vigorously opposed the Emerson counter merger proposal, refused to submit it to the shareholders, and refused Emerson's statutory demand that it furnish, or allow Emerson to examine, the list of Dodge shareholders (A. 110-12). Emerson obtained that list only upon judgment of the Circuit Court of St. Joseph County, Indiana in an action commenced in that court by Emerson (A. 113-22). The Dodge board called a special meeting of Dodge shareholders for August 22 to vote upon the Reliance merger (A. 130-31). The Board, by written communications, urged the shareholders to approve the merger (A. 130-31, 146-48). Emerson sought to have its merger offer submitted to the Dodge shareholders (A. 108-09, 122-24). Dodge management refused Emerson's request (A. 124-25). Emerson then resorted to a vigorous proxy contest in opposition to the Reliance merger (A. 125-26, 132-46, 149-54). Emerson brought suit in the United States District Court for the Northern District of Indiana to compel Dodge to afford Emerson access to Dodge shareholders, and to enjoin Dodge from making

false and misleading statements to its shareholders and others about Emerson's merger proposal (A. 127-29).

Emerson's attempt to compel submission of its merger proposal to the Dodge shareholders was unsuccessful. At the Dodge shareholder's meeting on August 22, the Reliance merger was approved, to become effective on or about September 30, 1967 [less than six months after Emerson's June 16th purchase of Dodge stock] (A. 65).

Between the period of the tender offer and the launching of the proxy contest, Emerson and its counsel became concerned about §16(b) of the Securities Exchange Act of 1934 (hereinafter referred to as the "Exchange Act"). Since, by virtue of its tender offer, Emerson had become the holder of more than 10% of the Dodge common stock on June 16th (A. 15, 17), and since there was a substantial danger that Emerson would be considered to have "sold" these shares (within the meaning of §16(b)) should the Dodge-Reliance merger be consummated despite its opposition, Emerson was faced with possible involuntary §16(b) short swing profit liability (A. 36).

On June 26, 1967, Emerson received the formal opinion of its counsel discussing both tax and §16(b) considerations presented by Emerson's Dodge tender offer shareholdings in the light of the anticipated Dodge-Reliance merger (A. 15-16, 33-38). With respect to §16(b), counsel concluded that (A. 38):

> "... it is important for Emerson to reduce its holdings of Dodge stock to less than 10% prior to the Dodge stockholders' meeting."

After the Dodge-Reliance merger was approved, but before it was consummated, the president of Emerson discussed with a representative of Goldman, Sachs & Co. a proposal by Emerson that Goldman, Sachs & Co. purchase

37,000 shares of the Dodge stock then held by Emerson. Prior to this conversation, Emerson had neither made an offer to sell nor received an offer to buy Dodge shares (A. 16). On August 28, 1967, Goldman, Sachs & Co. agreed to buy the 37,000 shares at $68 per share, less commissions, transfer taxes and stock exchange fees (A. 16, 41-42). The sale was consummated on the New York Stock Exchange that day (A. 155). Following the sale, Emerson still owned 115,282 shares, or 9.96% of the 1,157,437 total Dodge shares outstanding (A. 17).

The following day, Reliance's counsel telephoned Emerson's attorneys and suggested that Emerson sell its remaining Dodge stock to Dodge. Prior to this time, Emerson had not offered to sell any of these shares to anyone (A. 16-17). Negotiations with Reliance and Dodge officials ensued and, on September 11, 1967, a written agreement of purchase by Dodge of Emerson's 115,282 shares at $69 per share* was entered into (A. 43-45). The sale was closed on September 13, 1967 (A. 17).

In connection with and prior to this sale, both Dodge and Reliance, by their counsel, wrote Emerson advising Emerson that they had considered the §16(b) problems attendant upon the 37,000 share purchase by Goldman, Sachs & Co. and the proposed purchase by Dodge, and had no intention of asserting any §16(b) claim against Emerson "for any so-called 'short-swing' profits" which

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* As an integral part of the purchase contract, Emerson agreed (a) that it would take no action to obstruct the proposed merger of Dodge into Reliance; (b) that it would dismiss with prejudice certain pending litigation against Dodge; (c) that it would waive its rights as a dissenting stockholder of Dodge; and (d) that any tax ruling received by Emerson would not be used by it as the basis for any claims or court proceedings against Dodge or Reliance or any of their employees, officers or directors (A. 44, 46).

Emerson might realize with respect to the purchase by Dodge of the remainder of Emerson's stock (A. 48).

On September 29, 1967, Dodge merged into Reliance, and Dodge stockholders received shares of Reliance in exchange for their Dodge stock (A. 18).

In proxy materials, dated November 15, 1967, issued by Reliance in respect of a proposed merger of Toledo Scale Corporation into Reliance, Reliance discussed the then-completed purchase by Dodge of the 115,282 shares owned by Emerson (A. 155-56). Reliance reaffirmed its position that §16(b) was inapplicable, stating that:

> "'On September 13, 1967 Emerson sold 115,282 Dodge shares to Dodge at a price of $69 per share. *Reliance does not believe that Section 16(b) is applicable to such sale since Emerson was not then the holder of 10% or more of the outstanding shares of Dodge.* Counsel for Emerson furnished its opinion to that effect and counsel for both Reliance and Dodge concurred in that opinion." (A. 156.) (Emphasis added.)*

By letter dated December 28, 1967, the Reliance board of directors received a shareholder demand that they proceed against Emerson in an attempt to recover any profits Emerson might have made in Dodge stock (A. 7-8). Reliance responded, on February 13, 1968 (A. 8-9), by demanding from Emerson any short-swing profits made by it *on the first sale to Goldman, Sachs & Co.* However, Reliance, by its counsel, specifically declined, however, to make any demand with respect to Emerson's second sale of Dodge stock—the only sale in issue here. The letter read:

> "We have previously stated that, in our opinion, the profits which Emerson may have made on such sale are

* The "occurrence" opinion referred to is the September 11, 1967 letter of counsel for Dodge and Reliance. (A. 48).

not recoverable by Reliance, *since Emerson was not then the owner of 10% or more of the outstanding stock of Dodge.* Nothing has developed to change that opinion. Accordingly, our demand does not relate to the profits realized by Emerson on such sale." (A. 9.) (Emphasis added.)

Faced with this demand, Emerson on February 29, 1968 brought this action seeking a declaratory judgment as to its liability, if any, for profits on either of the sales of Dodge stock (A. 3-6). Reliance filed a counterclaim asserting, for the first time, and directly contrary to its prior position, that Emerson was liable for profits made on both sales. (A. 10-13).

SUMMARY OF ARGUMENT

The issue presented by this case is whether the sale by Emerson (a former owner, but *not* at the time of the sale, of more than 10% of Dodge stock) of 115,282 shares of Dodge stock is exempted from the "short swing" profit provisions of §16(b).

When Emerson sold its Dodge stock in two *bona fide,* independent, open, separate and deliberate sales to two different purchasers at two different times, it was merely following, pursuant to the advice of its counsel, the plain language of the exemption provision of §16(b) as Congress wrote and enacted it and presumably intended it to be applied. The first sale was intended to bring Emerson's remaining share ownership below the 10% ownership level, so as to bring the anticipated involuntary "sale," through merger, of the remainder within the exemption provision of §16(b). This also had the effect of placing the subse-

quent sale for cash at the instance of Reliance within the exempting provision, which clearly provides that sales by a former 10% holder are exempted from §16(b) if, when made, the seller owns 10% or less, even though made within six months from the time the seller initially became a 10% owner.

The statutory exemption which excludes Emerson's second sale is couched in clear, unambiguous language and is to be applied as written. "Construction" of the exemption, absent any threshold ambiguity, is inappropriate. Neither recited generalized purposes of the law nor legislative history may be invoked to contradict, restrict, expand or otherwise alter the plain language of the statutory exemptive provision.

The "interpretations" urged by Reliance and the SEC are in actuality requests that this Court rewrite the plain words of this statute to read differently from the words Congress itself wrote and enacted as law. Reliance and the SEC present no authority supporting their proffered positions. In fact, all prior authority respecting §16(b)'s exemption provision has been affirmatively and expressly to the effect that a second sale, at a time when the 10% owner no longer has over 10% of the class of stock, is exempt from §16(b). Emerson relied on this prior authority, as it had a right to do.

Even were the Court to consider this case in light of the general remedial purpose of §16(b) to curb abuses of inside information, Emerson's second sale would still be exempt. Emerson, opposed in every way by Dodge and its management, was in no position to acquire, and in fact did not acquire, inside information from Dodge or from any other source. Absent this, there was no potential for

abuse and imposition of liability upon Emerson would not serve the purposes of §16(b).

Assessment of liability would impose an artificial "insider" label on Emerson, at a time when it lacked that statutory status, would inflict on it an unconscionable liability and, ironically, confer upon Reliance a substantial windfall in the face of the fact that it suggested, negotiated, approved, facilitated and participated in the second sale.

ARGUMENT

I. SECTION 16(b) ON ITS FACE PROHIBITS ITS APPLICATION TO EMERSON'S SECOND SALE.

Explicit and unambiguous statutory provisions are to be applied as written. *United States* v. *Sullivan*, 332 U.S. 689, 693 (1948); *United States* v. *Martin*, 337 F.2d 171, 174 (8th Cir. 1964); *Vroon* v. *Templin*, 278 F.2d 345, 348 (4th Cir. 1960).

A. The Parties, The SEC And Both Courts Below Are Unanimous That Emerson Was Not A 10% Owner At The Time Of The Second Sale. The Last Sentence Of §16(b) Clearly Exempts That Sale From Liability.

Congress deliberately included in §16(b) an exemption provision limiting its application to persons who are "insiders" solely because they are owners of more than 10% of an issuer's securities.[1] This limitation is unambiguous. It reads:

> "This subsection shall not be construed to cover *any* transaction where such beneficial owner was not such *both* at the time of the purchase and sale, or the sale and purchase, of the security involved. . . ." (Emphasis added.)

By this straightforward provision, Congress exempted Emerson's second sale, which concededly[2] occurred when

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[1] Although the "beneficial owner" of §16(b) refers to an owner of *more* than 10% of the corporate securities involved, for purposes of brevity such an owner is hereinafter referred to as a "10% owner" or a "10% holder."

[2] See Brief of Petitioner Reliance (hereinafter "Reliance Brief"), page 4; Brief of Securities and Exchange Commission (hereinafter "SEC Brief"), page 4; Opinion of United States District Court for the Eastern District of Missouri, A. 162; and Opinion of the United States Court of Appeals for the Eighth Circuit, A. 179-80.

Emerson was no longer a 10% holder. *See Adler* v. *Klawans;* 267 F.2d 840, 845 (2d Cir. 1959). The Court of Appeals properly applied the Congressional exemption mandate.

The plain meaning of a statute may not be disregarded by the courts. *Sturges* v. *Crowninshield,* 17 U.S. (4 Wheat.) 122, 202-203 (1819); *United States* v. *Sullivan,* 332 U.S. 689, 692-93 (1948). As this Court has heretofore held, §16(b) must be applied as actually written by Congress, not as some litigant would have it written. *Blau* v. *Lehman Brothers,* 368 U.S. 403, 410 (1962).

The clear meaning of the exemption was understood by all parties to this case. On the basis of the express wording of the exemption provision of §16(b), Emerson's counsel advised his client that, while liability might attach to its first sale of Dodge stock made when it held more than 10% of that stock, any sale at a time Emerson owned less than 10% of the outstanding Dodge shares would be exempt (A. 35-38). At the closing of the sale of the 115,282 shares to Dodge, Reliance and Dodge and their counsel, then fully apprised of the facts of the first sale, all agreed that the second sale was exempt from §16(b) (A. 48-49). In addition, subsequent to the consummation of the merger of Reliance and Dodge, Reliance voluntarily and publicly affirmed this position in proxy material it issued in respect of an unrelated merger transaction (A. 156). Still later, confronted with a shareholder demand upon Reliance that it seek recovery against Emerson with respect to profits realized by Emerson on the second sale, counsel for Reliance again reiterated their opinion that the second sale was exempt from §16(b). Reliance accordingly limited its demand to profits on the first sale (A. 9).

In addition all prior analysis by scholars of §16(b) and its exemption provision had consistently concluded that the second sale was exempt if at that time the seller was no longer a 10% holder. As early as 1934, shortly after the Exchange Act was enacted, one commentator observed that:

> ". . . the intention of the language was to exclude the second sale in a case where 10% is purchased, 5% sold within three months, and the remaining 5% a month later. *This latter construction of the Act is, it is believed, the only safe one to rely upon.*" Seligman, "Problems Under the Securities Exchange Act," 21 Va. L. Rev. 1, 20 (1934). (Emphasis added.)

Professor Louis Loss reached the same conclusion:

> ". . . a person who owns 15 percent and wants to sell down to 5 percent should sell 5-plus percent in one transaction and then, after he becomes a holder of slightly less than 10 percent, sell out the remainder." 2 Loss, *Securities Regulation* 1060 (2d Ed. 1961).[3]

Furthermore, four federal courts, as well as the SEC, indicated that a sale of shares by a one time 10% owner falls within the liability provisions of §16(b) only if he is a 10% holder *at the time of the sale.* As the court said in *Stella* v. *Graham-Paige Motors Corp.,* 104 F.Supp. 957, 960 (S.D.N.Y. 1952), citing *Seligman, supra*:

> "Assuming that a shareholder becomes subject to the liability imposed by the statute immediately upon be-

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[3] In a later supplement, Professor Loss corrected his earlier text to note that the shareholder need only sell down *to* 10% (rather than *under* 10%) and thereafter may dispose of the remainder of his shares free of §16(b). 5 Loss, *Securities Regulation* 3023 (Supp. 1969).

> coming the owner of more than 10% of the equity shares of a corporation, it would appear that the exemption provision was intended 'to exclude the second sale in a case where 10% is purchased, 5% sold within three months and the remaining 5% a month later.' "

The SEC urged that interpretation upon the court in the *Stella* case in its *amicus* brief saying in that regard:

> "The exemption applies only to transactions of purchase and sale when the stockholder has less than ten per cent of any class of equity securities of the issuer. Thus any purchases or sales made by defendant prior to February 10, 1947 [the date of the purchase by which Graham-Paige became a 10% stockholder] would not be included in any computation of profit. *Obversely, the exemption would exclude any sales made after defendant ceased to be a ten per cent holder.*" (Emphasis added.) Brief for SEC as Amicus Curiae at 7-8.

Accord, Feder v. *Martin Marietta Corp.*, 406 F.2d 260, 266-67 (2d Cir. 1969), *cert denied*, 396 U.S. 1036 (1970);[4] *Ad-*

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[4] "It must be emphasized, of course, that the statute evidences a clear legislative intent to treat corporate directors and officers in one category of insiders and 10% shareholders in another. The act expressly sets forth that the liability of a 10% shareholder to surrender his short-swing profits is conditional upon his being such both at the time of purchase and at the time of sale, but there is no such limitation in the case of officers and directors. [Adler v. Klawans,] 267 F.2d at 845; Blau v. Allen, 163 F.Supp. 702, 704 (SDNY 1958). See also 2 Loss, Securities Regulation 1060 (2d ed. 1961)." 406 F.2d at 266-67. (Footnote omitted.)

ler v. *Klawans*, 267 F.2d 840, 845 (2d Cir. 1959);[5] *Blau* v. *Allen*, 163 F.Supp. 702, 704 (S.D.N.Y. 1958).[6]

Since the foregoing interpretation of §16(b) was made by the courts, the interested legal community and the public,

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[5] "The statute itself, independent of its legislative history, seems to treat directors and officers as one category of 'insiders' and 10% beneficial owners as another. There is, of course, a logical and practical basis for distinction. Generally, although there are important exceptions in certain circumstances, officers and directors have more ready access to the intimate business secrets of corporations and factors which can affect the real and ultimately the market value of stock than does even so large a stockholder as a '10% beneficial owner.' This is not to discount the potential influence of the latter but simply to acknowledge the basis for the different treatment accorded them by Congress. Moreover, a director or officer can usually stimulate more directly actions which affect stock values and have knowledge of factors which might depress values. Notwithstanding exceptions and variations these general propositions have a foundation in experience and furnish an adequate basis for a difference in treatment of 10% owners. Beyond doubt it was considerations of this character which led Congress to make a provision concerning 10% owners which was not made with respect to officers and directors. It is found in the language:

> 'This subsection shall not be construed to cover any transaction where *such beneficial owner* was not such *both* at the time of purchase and sale, or the sale and purchase, of the security involved * * *' (Emphasis added.)

"Under the familiar canon of construction, *expressio unius est exclusio alterius*, the presence of this emphatic and unmistakable clause in the portion governing the one class demonstrates a clear legislative intent that no such provision applies to the other. [Citations omitted.]" 267 F.2d at 845.

[6] "In addition, it is significant that while the proscriptions of section 16(b) apply to a 10% beneficial owner only if he is such both at the time of purchase and sale, there is no such limitation in the case of officers and directors." 163 F.Supp. at 704.

commencing at a time shortly after the enactment of the statute and has been persisted in over many years, and since Congress has not seen fit to amend §16(b) in any respect, although it amended other sections (including §16(a)) of the Exchange Act, application of the rule of contemporaneous construction and interpretation is warranted. The long continued contemporaneous construction of §16(b) by the bar is entitled to great weight. *Pen-Ken Gas & Oil Corp.* v. *Warfield Natural Gas Co.*, 137 F.2d 871, 880 (6th Cir. 1943); *McBrien* v. *Warden, State Prison*, 216 A.2d 432, 438 (Conn. 1966); *see* 2 Sutherland, *Statutory Construction*, §§5103-04, 5106-07, 5109 (3d Ed. 1943).

This Court has often held that failure of the Congress or a state legislature to amend a statute in the face of continuing contemporaneous construction is presumptive evidence of the correctness of that construction. *Electric Storage Battery Co.* v. *Shimadzu*, 307 U.S. 5, 14 (1939); *Missouri* v. *Ross*, 299 U.S. 72, 75 (1936); *United States* v. *Elgin, Joliet & Eastern Ry.*, 298 U.S. 492, 500 (1936).

Until the decision of the district court in this case, which the Court of Appeals reversed, the rule stated above has been unanimously accepted by all of the authorities who have dealt with the question. Neither Reliance nor the SEC has presented any authority whatsoever which is arguably to the contrary, and we have found none. Indeed, it was not until Reliance in this case executed an about face and claimed that Emerson was liable to it for the short swing profits that resulted from Emerson's second sale that any agency, law commentator or court had even *suggested* any doubt respecting the clear command of the exemption provision of §16(b).

B. Other Language In §16, And The Rules And Regulations Promulgated By The SEC, Buttress The Conclusion Of The Court Of Appeals.

Section 16(b) applies to "such" beneficial owner; the owner referred to is the one defined in the monthly reporting requirements of changes of ownership contained in §16(a), *i.e.*, "the beneficial owner of more than 10 per centum of any class of any equity security . . . which is registered on a national securities exchange." 15 U.S.C. §78p(a). Section 16(a) does not require a monthly report of changes in ownership by one holding less than a 10% stock position during that month.

Inasmuch as Emerson's second sale of Dodge stock occurred in September, 1967, on no day of which was Emerson a 10% owner, Emerson had no obligation under §16(a) to report that sale. Not being subject to §16(a), Emerson was *ipso facto* not a "beneficial owner" within §16(b). *Cf. Simon* v. *Sunasco, Inc.*, [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶92,547 at page 98,510 (S.D. N.Y. 1970).

This conclusion is confirmed by the SEC's own rules in this area. Section 16(b) contains an exemption for "any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." Pursuant to this authority, the SEC by Rule 16a-10[7] exempted from §16(b) those transactions exempt from §16(a). The SEC only requires reports under §16(a) of stockholders (other than officers and directors) who are 10% owners in the particular

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[7] "Any transaction which has been or shall be exempted by the Commission from the requirements of section 16(a) shall, in so far as it is otherwise subject to the provisions of section 16(b), be likewise exempted from section 16(b)." 17 C.F.R. §240.16a-10.

month. Form 4, SEC Release No. 6487 of March 9, 1961.[8]

Since Emerson was not a 10% owner in September, 1967, it did not have to report under §16(a) and was exempt from §16(b).

II. CONGRESS INTENTIONALLY LIMITED THE REACH OF §16(b).

Congress enacted §16(b) of the Exchange Act:

> "[f]or the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner [i.e., the owner of more than 10% of the issuer's securities] . . . by reason of his relationship to the issuer . . . ." 15 U.S.C. 78p(b).

In implementing this purpose, Congress deliberately chose not to cover the full range of possible abuses of inside information[9] by §16(b). Liability is imposed only upon

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[8] Instructions to Form 4 state in part:

> "1. Persons Required to File Statements.
> Statements on this form are required to be filed by each of the following persons:
> (a) Every person who at any time during any calendar month was (i) directly or indirectly the beneficial owner of more than 10 percent of any class of equity securities (other than exempted securities) listed and registered on a national securities exchange . . . and who during such month had any change in his beneficial ownership of any class of equity securities of such company. . . ."

[9] "Large areas of 'insider' conduct were consciously left untouched by Congress for reasons dictated by practicalities rather than ethics or pure logic. A line had to be drawn somewhere by the lawmakers. . . ." *Adler* v. *Klawans*, 267 F.2d 840, 845 (2d Cir. 1959). *Accord, Blau* v. *Max Factor & Co.*, 342 F.2d 304, 307 (9th Cir. 1965), *cert. denied*, 382 U.S. 892 (1965).

certain persons (officers, directors and 10% owners), and only in specific circumstances (when purchases and sales, or sales and purchases, occur within a period of less than six months, and in the case of a 10% owner only if he owns more than 10% of the stock at the time both of purchase and of sale).

There are many instances of actual use of inside information that §16(b) does not cover. *See, e.g.*, 2 Loss, *Securities Regulation* 1042-43 (2d Ed. 1961). Sales on dates six months or more after acquisition of the 10% ownership are exempt—the difference need be only one day.[10] An insider may trade for years on the basis of inside information without being covered by §16(b) if he avoids matching transactions within less than 6 months. Trading by persons owning substantial amounts of stock, but 10% or less, is exempt.[11] Corporate employees who are not officers or directors are not covered by §16(b) even though they have inside information. *See, Lockheed Aircraft Corp.* v. *Campbell*, 110 F.Supp. 282, 286 (S.D. Calif. 1953). The section does not apply to trades by noninsider tippees[12], and mutual trading by corporate insiders on re-

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[10] ". . . for the insider who waits six months and one day after purchase to avoid a short term gain there is no 'bite' at all except as conscience calls the use of inside information on sales after six months as reprehensible as on sales within six months. One can speculate on whether the moral or ethical values are altered by the passage of 24 hours but the statute makes an honest if not honorable man out of the insider in that period." *Adler* v. *Klawans*, 267 F.2d 840, 845 (2d Cir. 1959).

[11] Earlier drafts of the section fixed 5% rather than 10% stock ownership as the "insider" definition. *See* §15(b), H.R. 7852 and S. 2693, 73d Cong., 2d Sess. (1934).

[12] Early drafts of the Act would have prohibited tipping. See §15(b), H.R. 7852 and S. 2693, 73d Cong., 2d Sess. (1934).

ciprocal tips is exempt. 2 Loss, *Securities Regulation* 1043 (2d Ed. 1961); *Blau* v. *Lehman*, 368 U.S. 403, 411-12 (1962).

This intentionally limited scope is proper in light of the automatic liability imposed by §16(b), *Bershad* v. *McDonough*, 428 F.2d 693, 696 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), under which the innocent are liable as well as the guilty. *See Ferraiolo* v. *Newman*, 259 F.2d 342, 344 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959).

Section 16(b)'s limited scope is additionally appropriate when viewed against the complementary remedies of a more general nature afforded by other provisions of the Exchange Act. For example, the Exchange Act also contains Section 10(b), implemented by SEC Rule 10b-5, which prohibits all acts and courses of conduct connected with securities transactions that are fraudulent or manipulative. All of the instances noted above as abuses of inside information not covered by §16(b) are prohibited by Rule 10b-5. *See SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 852 (2d Cir. 1968), *cert. denied sub nom. Kline* v. *SEC*, 394 U.S. 976 (1969), (trading by insiders and tippees on inside information).[13]

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[13] Reliance suggests (Reliance Brief, page 10 n. 5) that §10(b) is an inadequate alternative to Reliance's urged reading of §16(b), on the grounds that §10(b) is not applied automatically but requires a factual inquiry into actual abuse. Yet Reliance is the one who here contends that §16(b) should *not* be "automatically" applied as written to exempt Emerson's second sale, and who urges this Court to adopt a new element of §16(b) [*i.e.*, intent of defendant as to "predetermined plan of disposition"] which would necessitate factual inquiry on a case-by-case basis.

Reliance and the SEC insist that even though Emerson's second sale is not within the words of §16(b),[14] that provision should be expanded, in fact rewritten, to impose liability, and this in the face of the fact that §16(b) is drafted so as to make it applicable to a limited number of factual situations.

III. NONE OF THE "PRINCIPLES OF CONSTRUCTION" URGED BY RELIANCE AND THE SEC SUPPORT THEIR REQUESTED REWRITING OF THE EXEMPTION PROVISION OF §16(b).

Everyone concedes that Emerson owned only 9.96% of Dodge's stock when it made its second sale. However, both Reliance and the SEC, upon different theories, request this Court to "construe" §16(b) to cover that sale by *rewriting* the exemption provision to their individual specifications. The statute expressly says that this *shall not* be done.[15]

A. Both Reliance And The SEC Would Have This Court Emasculate The Exemption Provision Of §16(b).

Reliance's position is that the exemption provision of §16(b) protects 10% holders who inadvertently or accidentally sell or otherwise dispose of their stock sufficient to reduce their holdings to less than 10% and then sell the remainder, but not to 10% holders who knowingly and deliberately do so in order to avoid the penalty provisions

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[14] Reliance realizes that §16(b) as written does not cover Emerson's second sale when it suggests that, in this respect, there is a "deficiency" in the statute. Reliance Brief, page 10, n. 5.

[15] " . . . this subsection *shall not be construed* to cover any transactions where [the 10% holder] . . . was not such . . . at the time of the . . . sale . . . ." 15 U.S.C. 78p(b). (Emphasis added.)

of §16(b). Reliance reaches this startling result by reading the word "sale" to cover multiple sales when the 10% holder has a predetermined plan to dispose of his stock in several sales within six months. (Reliance Brief, "Question Presented", page 3).

In the first place, Reliance's argument is factually wrong. There is no dispute that the first sale was made because Emerson feared that the forthcoming Reliance-Dodge merger, which it had opposed, would result in an *involuntary* "sale" of Emerson's stock within the meaning of §16(b). Emerson sold enough to reduce its holdings below 10% in order to avoid such a result. The second sale, *i.e.* the sale to Dodge, was *concededly not anticipated* at the time of the first sale, and was initiated by Reliance, not Emerson.

This reading is contrary to the statute,[16] prior §16(b) cases,[17] the record and the opinions of the two courts below. Reliance's suggestion that Emerson's two sales should be treated as one "sale" for §16(b) purposes has already been twice rejected. Although the district court did construe "time of sale" (A. 164), it found as a fact that "the two sales of Dodge stock were technically separate transactions and the second sale was not 'legally' tied in any way to the first sale" (A. 163); this latter finding was expressly adopted by the Eighth Circuit (A. 180).

All of the cases cited by Reliance in support of its proposition deal with the issue of whether one event, not considered a purchase or sale in normal parlance(*e.g.*, an option, exchange of shares pursuant to merger, or conversion of convertible preferred stock), is nevertheless a purchase or sale as broadly defined by the statute. None

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[16] *See* pp. 13-16 *supra.*

[17] *See* pp. 26-32 *infra.*

support the proposition, urged here by Reliance although neither court below agreed, that the *two totally independent sales* constituted "a sale" for purposes of §16(b).[18]

The SEC, on the other hand, does not share Reliance's concept of treating the two sales as a single "sale". The SEC's theory is that the words "at the time of the purchase *and* sale" should be ignored if at any time within the six month period preceding a sale the seller was a 10% shareholder. The SEC disregards the fact that the exemption provision of §16(b) deals with the status of the 10% holder at the time of *each* purchase or sale.[19]

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[18] *Abrams* v. *Occidental Petroleum Corporation*, 323 F.Supp. 570 (S.D.N.Y. 1971), *appeal docketed*, Nos. 71-1273-4-5-6, 2d Cir., and *Stella* v. *Graham-Paige Motors Corp.*, 132 F.Supp. 100 (S.D.N.Y. 1955), *modified in other respects*, 232 F.2d 299 (2d Cir. 1956), *cert. denied*, 352 U.S. (1956), cited by Reliance at pages 21-22 of its brief, are not authority to the contrary. In *Abrams*, the district court concluded that defendant's tender offer constituted "one act". It did *not* hold, as Reliance erroneously implies, that all the individual purchases pursuant to the offer together constituted "one purchase."

In *Stella*, the district court was concerned with whether three sales of stock, to two different purchasers, were sold within the less-than-six-month period. Defendant in that case owned, at the time of and following each of the three sales, more than 10%. Contrary to Reliance's citation of this case for the proposition that two independent sales may be treated as one sale (Reliance Brief, page 22), the court in *Stella* found that the sales occurred on *two* dates and spoke of *multiple* sales and contracts to sell.

[19] The SEC argues: "A person is liable under Section 16(b) of the Securities Exchange Act of 1934 for profits realized by him from a purchase followed within six month by *sales* of a corporation's stock, where such person becomes a more than 10 percent beneficial owner of the corporation's stock by virtue of the purchase and is a more than 10 percent beneficial owner *at any time* during the period in which the *sale transactions* occur." SEC Brief, page 14. (Emphasis added.)

Under the SEC's reading, if a purchaser holds 10% at the time of his purchase, §16(b) applies to *all* sales made by him during the ensuing six months period irrespective of the amount of his holdings at the times of those sales. Thus, the SEC would hold a shareholder liable for all sales made by him when he buys 12% on January 1 and sells 3% on February 1, 3% on March 1, 3% on April 1, 2% on May 1, and 1% on June 25.[20]

If the position of either Reliance or the SEC is adopted, the words of the exemption provision of §16(b) that the section does not apply to a seller who holds less than 10% "*both* at the time of the purchase and sale" are rendered meaningless. This would be contrary to the settled doctrine of construction that courts will not nullify an unambiguous statutory provision under the guise of construction. *City Nat. Bank.* v. *United States,* 207 F.2d 741, 744 (10th Cir. 1953).

Reliance does not even pretend that its proffered position is supported by legislative history. However, the SEC seizes upon an isolated exchange (a question and answer suggesting that the section was not intended to apply to executors and administrators selling stock owned by an estate, see SEC Brief, pages 32-33) during the Senate hearings concerning §16(b) and, by a strained reading, asks this Court to "presume" that the exemption, which was subsequently put into the section, was designed to exclude shareholders who "involuntarily" achieve 10% status.[21]

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[20] Indeed, the SEC would appear to contend that an owner is liable on all sales where he buys 5% on January 1 and 6% on February 1, and sells 3% on April 1, and 8% on June 1.

[21] Thus the SEC would apparently credit the exemption with meaning only where the 10% holder became such as an executor, administrator, trustee, devisee or donee, or where the percentage of his holdings has been mechanically increased by purchases or redemptions by the issuer. SEC Brief, page 30.

At best, the SEC's legislative history is irrelevant. When the provision of a statute is unambiguous, as is the one here, courts restrict themselves to the statute as written, and do not resort to legislative history to ascertain legislative intent; this for the obvious reason that the statutory provision needs no construction. There is no need to do anything but apply the statute as written by Congress. *United States* v. *Oregon,* 366 U.S. 643, 648 (1961).

Even when legislative history is consulted, it must be clear authority for the interpretation urged; the sheer speculation indulged in here by the SEC[22] to provide support for its version of the statute is insufficient. As this Court stated in *Gemsco, Inc.* v. *Walling,* 324 U.S. 244 at 260 (1945):

> "The argument from the legislative history undertakes, in effect, to contradict the terms of [the statute] by negative inferences drawn from inconclusive events occurring in the course of consideration of the various . . . bills which finally . . . emerged . . . as the Act. The plain words and meaning of a statute cannot be overcome by a legislative history which, through strained processes of deduction from events of wholly ambiguous significance, may furnish dubious bases for inference in every direction. This is such a case."

Finally, the most conclusive evidence that Congress did not intend §16(b) to mean what the SEC says (*i.e.* that only involuntary 10% holders are exempt)[23] is the incontroverti-

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[22] *See, e.g.,* SEC Brief, page 32.

[23] To the extent that Congress was in fact concerned about inadvertently imposing liability on the particular classes of holders mentioned by the SEC, it should be noted that the coverage of the statute finally passed—"beneficial owner"—was a revision of the first public draft of the Act which spoke of "owner of securities, owning *as of record and/or beneficially.*" H.R. 7852, 73d Cong., 2d Sess. §15(b) (1934). (Emphasis added.)

ble fact that Congress did not write the exemption provision in terms of "involuntary" 10% holders.[24] As the court said in *Vroon* v. *Templin*, 278 F.2d 345 at 348-49 (4th Cir. 1960):

> "The language of the statute is plain and is to be taken as written. We do not think it permissible to construe a statute on the basis of a mere surmise as to what the Legislature intended and to assume that it was only by inadvertence that it failed to state something other than what it plainly stated. *This is particularly true* when there is no confusion or lack of clarity in the wording of the statute and *where it could so easily have been worded to provide the meaning* [being advanced] . . . *had the law-making body so desired.*" (Emphasis added.)

B. Incantation Of "Remedial Purpose Of The Act" Does Not Justify Rewriting The Statute.

1. Application Of The Unambiguous Exemption Provision To The Ordinary Cash Sale Here Does Not Require "Construction".

Reliance and the SEC, focusing only on the "remedial purposes" of the statute rather than on the express language of the section itself, ask this Court to rewrite and

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[24] The SEC's own Regulations cast doubt on its speculation that Congress in writing the exemption was solely concerned with "involuntary" 10% holders. Six months after §16(b) became effective, the SEC found it necessary to adopt a regulation excluding from §16(b) coverage, for 12 months after their involuntary acquisition, executors, guardians and certain other administrators of estates or assets. SEC Rule 16a-4, 17 C.F.R. §240.16a-4. If Congress was in fact attempting only to exempt "involuntary" 10% holders, the SEC apparently concluded in 1935 that Congress was not entirely successful in this attempt.

extend the reach of §16(b). They blithely ignore and seek to have this Court ignore the plain language Congress itself employed in expressly limiting the reach of the section. They ask the Court to overlook the fact that Congress intentionally *declined* to enact a statute coextensive with the recited purpose. Unambiguous statutory language may not be abandoned to pursue "remedial purposes."

Section 16(b) was initially considered to be largely "automatic"—a "crude rule-of-thumb"[25] to minimize protracted litigation. *See Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 235 (2d Cir. 1943), *cert. denied*, 320 U.S. 751 (1943).

Subsequently, it became clear that "automatic application" was often impossible or inappropriate. For example, a situation arose where the language of §16(b) was arguably ambiguous and the court turned to interpretive guidelines. The question was whether the words "at the time of purchase" meant simultaneously with the purchase or immediately prior thereto. It was held in *Stella* v. *Graham-Paige Motors Corp.*, 104 F.Supp. 957, 960 (S.D.N.Y. 1953) that the phrase meant simultaneously with the purchase. In a second class of cases, unambiguous words of the statute, applied literally[26] to certain variant corporate transactions, swept into statutory coverage equitably "innocent" conduct which had not concerned Congress. With respect to this latter category of cases,

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[25] *Hearings on S. 84, S. 56 and S. 97 Before the Senate Committee on Banking and Currency*, 72d Cong., 2d Sess. and 73d Cong., 1st and 2d Sess. at 6557 (1934).

[26] The terms 'buy' and 'purchase' each include any contract to buy, purchase, *or otherwise acquire*." 15 U.S.C. 78c(a)(13). (Emphasis added.)

"The terms 'sale' and 'sell' each include any contract to sell *or otherwise dispose of*." 15 U.S.C. 78c(a)(14). (Emphasis added.)

the court said in *Newmark* v. *RKO General, Inc.*, 425 F.2d 348, 351 (2d Cir. 1970), *cert. denied*, 400 U.S. 854 (1970):

> "The complexities of the commercial and financial world, however, have defied the draftsmen's efforts at neat classification. Whether certain 'unorthodox' transactions, well illustrated here by the exchanges of securities incident to a merger which form the basis of this appeal, are 'purchases' or 'sales' for the purposes of section 16(b) cannot be resolved by mere reference to the words of the statute. In such cases, the determination of the statute's relevance must rest, initially, on whether there exists the potential for evil against which the statute was intended to guard."

In response to these two limited classes of cases, the courts developed the "pragmatic approach" of measuring the particular facts of a case against the remedial purposes of the Act—to resolve ambiguity or to determine whether a holder, although technically *within* the statute as written, was not within its spirit, and should be *excluded* from coverage. In the case at bar, Reliance and the SEC are asking this Court to *include* in the statute's coverage a holder patently *without* the plain terms of §16(b) as written, to eliminate altogether the basic concept of applying the exemption as written where possible, and to extend unwarrantedly the device of reference to the remedial purposes of the Act.

Reliance would read "sale" as "sales"; the SEC would read "at *the* time of *the* purchase and *sale*" as "*sales* at *any* time." But here there was a simple sale of stock for cash and the statutory dictates are unambiguous. Emerson finds no case where a court faced with a straightforward cash-for-stock sale found it necessary to revert to the remedial purposes statutory construction doctrine to import an ambiguity into otherwise plain words of the stat-

ute and then by the same device resolve the self-created ambiguity, in the process changing the plain words of the statute.[27] The Court of Appeals properly applied the statute as written, which was the intention of the Congress.

Reliance (Brief, pp. 12-13) criticizes the Court of Appeals for its refusal to resort to the doctrine of remedial construction as a means of warping the otherwise plain language of §16(b) to make it applicable to Emerson's second sale. The criticism is unwarranted and misplaced. The Court of Appeals concluded, and soundly so, that the words of the exemption provision, that the seller must be the owner of more than 10% "both at the time of the purchase and sale", were plain and unambiguous so as to exclude from §16(b) a sale by a seller who, though initially an owner of more than 10%, was not a more-than-10% owner at the time of sale, irrespective of whether the interim reduction of his ownership percentage below 10% was deliberate, inadvertent or involuntary. It refused to join Reliance in reading into the statute a distinction between sellers who had intentionally reduced their ownership to less than 10% and those who had become so inadvertently.[28]

The Eighth Circuit applied the approach proper in such cases. The issues presented to the Court of Appeals were: (1) whether Emerson's profits on both sales were exempt

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[27] Similarly, courts refuse to "construe" clear-cut statutory language by deleting words from §16(b). *See, e.g., Stella* v. *Graham-Paige Motors Corp.*, 132 F.Supp. 100, 104 (S.D.N.Y. 1955) [the words "less than" may not be deleted from the phrase "within any period of less than six months"].

[28] Reliance cites *Chemical Fund, Inc.* v. *Xerox Corp.*, 377 F.2d 107 (2d Cir. 1967), as an instance in which a court "construed the '10% beneficial owner' standard in light of the statutory purpose of Section 16(b) . . ." Reliance Brief, page 14. Reliance misapprehends the point of the *Chemical Fund* decision. The portion of §16(b) at issue in that case was not "10% beneficial owner" but rather "class of any equity security." 377 F.2d at 108.

since Emerson's Dodge holdings jumped from zero to 13.2% at the instant the tender offer was consummated, and Emerson was arguably therefor not a 10% owner "at the time of purchase", and (2) the issue presented here, of whether Emerson was a 10% owner at the time of its second sale. Since the Court of Appeals found that in its judgment a threshold statutory ambiguity was involved in the first issue, it properly resorted to legislative history and other pragmatic analysis of remedial purposes and held that the words "at the time of purchase" meant "simultaneously with."[29]

On the present issue, however, the Court of Appeals recognized that "remedial purposes" cannot serve as a substitute for words of plain meaning in a statute. Despite its expressed determination to apply §16(b) to the fullest extent possible, the Court of Appeals correctly held that resort to collateral aids to determine legislative intent was impermissible with respect to Emerson's second sale. The Court of Appeals said in that regard:

> ". . . While we agree that Section 16(b) is to be broadly and liberally construed to achieve the intent of Congress, we are unable to discern from any of the Congressional hearings or from the broad basic purpose of 16(b) any intent on the part of Congress not to mean what it has literally said in the 16(b) exclusion clause, giving the words used in that clause a liberal and reasonably flexible meaning. We are not free under the guise of statutory interpretation to

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[29] Emerson disagreed with the Eighth Circuit's conclusions that the words "at the time of" are ambiguous and that legislative intent is served by reading those words as "simultaneously with." But that issue need not be decided by this Court in this case, since it is conceded by all parties that Emerson was not a holder of "more than 10%" at the time of the second sale. There is no threshold statutory ambiguity as to the applicability of the exemptive provision of §16(b) to the sale involved in this case.

rewrite statutes so as to include matters which for unexpressed reasons Congress did not include." (A. 182.) (Footnote omitted.)

This refusal to do by construction what Congress did not itself do by legislative drafting is sanctioned by all §16(b) precedent and is specifically mandated by this Court in *Blau* v. *Lehman Brothers*, 368 U.S. 403, 411-12 (1962).

2. The Remedial Purposes Of The Act Do Not Support The Application Of §16(b) To The Facts Of This Case.

Even if inquiry into the remedial purposes of the Act were made here, the conclusion reached by the Court of Appeals still follows, that Emerson's second sale is exempted. The purchase and two sales of Dodge stock simply were not an abuse and do not present possibilities of abuse.

Courts construing §16(b) have properly refused to apply §16(b) beyond its purpose[30] of dealing with speculative abuse of inside information. For "remedial purposes" to be relevant, therefore, it must appear both that "the transaction" empowered the defendant to engage in speculative abuses[31] and that those abuses involved the

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[30] "For the purpose of preventing *the unfair use of information* which may have been obtained by [a 10% holder] . . . *by reason of his relationship to the issuer*. . . ." (Emphasis added.) 15 U.S.C. 78 p(b).

[31] *See, e.g., Blau* v. *Lamb*, 363 F.2d 507, 524 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967) (conversion of convertible preferred stock into common stock not a "sale" of the convertible preferred for §16(b) purposes; defendants' power as insiders to abuse inside information pre-dated the conversion, and was in no way enhanced because of it); *Blau* v. *Max Factor & Co.*, 342 F.2d 304, 308 (9th Cir. 1965) (exchange of common for Class A (common) stock not a "purchase" of the Class A stock for §16(b) purposes; defendant's ability to engage in speculative use of inside information existed *before* the exchange).

use of inside information.[32] Neither factor existed here.[33] Emerson was at all times foreclosed from *any* access whatsoever to inside information.

It is clear that Emerson fought vigorously to acquire control of Dodge. It made overtures to the management of Dodge (A. 59) which were vigorously rejected (A. 59). Emerson then launched a tender offer directed, over the heads of the resisting Dodge management, to the Dodge shareholders (A. 19-31). Dodge management vigorously resisted and succeeded in frustrating Emerson's offer. Dodge management resorted to all of the standard devices of resistance. Broadside communications were sent to Dodge shareholders urging them to reject the tender offer (A. 74-77). Dodge management brought suit to enjoin Emerson from proceeding with its tender offer (A. 81-90). Dodge management refused to give or afford Emerson access to a shareholder list until compelled to do so by court order on suit by Emerson (A. 113-22). Dodge management pre-empted Emerson's tender offer by negotiating a "defensive merger" with Reliance (A. 78-80). Emerson then conducted an unsuccessful proxy fight against the merger (A. 125-26, 132-46, 149-54). Emerson sold 37,000 shares of its Dodge stock to Goldman, Sachs & Co. to avoid being in the position of making an involuntary "sale" through

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[32] ". . . [T]he making of the exchange, and its timing, were simply irrelevant to the use of insider information in short-term speculation—the problem with which §16(b) is concerned. If [defendants] acted upon inside information in disposing of their stock interest when they did, the exchange was unrelated to that fact. . . ." *Blau* v. *Max Factor & Co.*, 342 F.2d 304, 309 (9th Cir. 1965).

[33] Reliance implies in its brief that the Eighth Circuit "recognized" that there was abuse *in this case*. Reliance Brief, page 13. Any fair reading of the Eighth Circuit's opinion demonstrates that this is simply not so.

the forthcoming merger, while a holder of more than 10% of Dodge's stock. It later sold its remaining Dodge stock to Dodge itself at the instance of the actual "insiders", the managements of Dodge and Reliance.

Throughout these proceedings, the hostility of the Dodge management to Emerson was demonstrable. Management fought at every turn and successfully precluded Emerson from the possibility of any access to inside information; indeed, in denying Dodge's motion for a preliminary injunction, the United States District Court for the Northern District of Indiana expressly found that Emerson had no insider information (A. 97). On the facts of *this* case, as opposed to the hypothetical facts posed by Reliance and the SEC, a holding that Emerson is liable for its second sale would not advance the remedial purposes of the Act. It would award an unconscionable windfall to the real insiders.

3. The Court Should Decide This Case On Its Facts And The Law Applicable Thereto, And Not The Parade Of Horribles Hypothesized By Reliance And The SEC.

Reliance and the SEC, straining to shore up their contention that this Court should re-write the statute, launch upon a parade of horribles which they hypothesize may result if this Court applies the statute as Congress wrote and enacted it. (Reliance Brief, page 10; SEC Brief, pp. 23-25).

Both ask this Court to accompany them on their flights of fancy, to turn its eyes from the facts of this case, to assume that all (who openly and pursuant to legal advice) seek to avoid statutory pitfalls are evil and to hold Emerson liable on the basis of nonexistent, invented "fact situa-

tions", tailor-made to lead to a conclusion of liability.[34] Further, the majority if not all of these hypothetical misdeeds would be reached by the broad remedial sanctions of Section 10(b) and Rule 10b-5.[39] Finally, if Reliance and the SEC are truly concerned with these speculated horribles, their proper recourse is to the Congress—rather than seeking, by a completely strained construction of a clearly worded statute, to impose liability upon one who acted according to the law.

In *Blau* v. *Lehman Brothers*, 368 U.S. 403, 410-11 (1962), the SEC similarly advanced a parade of horribles to persuade this Court to rewrite §16(b) to say what it does not. There, the plaintiff and the SEC contended that the statu-

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[34] Reliance's hypothetical (Reliance Brief, page 10) assumes both access to and intentional speculative abuse of inside information; by so doing, it would avoid attempting to cope with the fact, discussed above, that *in the case at bar* there was neither the fact nor the possibility of access to insider information by Emerson.

The SEC's hypotheticals go even further afield. The first (SEC Brief, page 24) not only assumes both the possibility and the fact of access to inside information, but assumes so friendly a relationship between holder and issuing corporation that the holder can obtain inside information *prior* to any purchase of stock. The second hypothetical (SEC Brief, page 24) is not even a §16(b) hypothetical, for it is directed to "manipulative practices." The SEC's third hypothetical would assume out of the present case (as would Reliance) that a holder in Emerson's position has no possibility of access to inside information.

[35] *See* p. 20 n. 13 *supra*. Even the SEC recognizes that this focus by the district court and Reliance upon the intent with which Emerson made its first sale is in conflict with the "Congressional desire that Section 16(b) operate as objectively and automatically as possible." SEC Brief, page 9.

tory word "director" should be read as "partnership to which a director belongs." The Court rejected this request that it indulge in judicial legislation, saying:

> "One may agree that petitioner and the Commission present persuasive policy arguments that the Act should be broadened in this way to prevent 'the unfair use of information' more effectively than can be accomplished by leaving the Act so as to require forfeiture of profits only by those specifically designated by Congress to suffer those losses. But this very broadening of the categories of persons on whom these liabilities are imposed by the language of §16(b) was considered and rejected by Congress when it passed the Act." 368 U.S. at 411-12. (Footnote omitted.)

When asked, for the sake of prophylactic effect, to make the director liable for the total profits of Lehman Brothers, the Court said:

> " . . . [L]iability under §16(b) is to be determined neither by general partnership law nor by adding to the 'prophylactic' effect Congress itself clearly subscribed in §16(b)." 368 U.S. at 413-14.

The exemption to §16(b) is explicit. As this Court said in *62 Cases of Jam* v. *United States*, 340 U.S. 593 at 600 (1951), despite a litigant's purported "anxiety to effectuate the congressional purpose of protecting the public [the Court] . . . must take care not to extend the scope of the statute beyond the point where Congress indicated it would stop." If there are "loopholes" in the statutory fabric, the SEC should ask Congress to mend them. Emerson considered the law, and acted as the law allowed.

C. The Arguments Of "Substance Over Form" And "Fiduciary Duty" Advanced By Reliance And The SEC Do Not Warrant A Rewriting Of The Exemption Provision To Cover Emerson's Second Sale.

Reliance and the SEC advance, as legal theories by which they would have the Court move from general remedial principles to Emerson's liability for the second sale, two different arguments: "substance over form" (including the tax refinement of "step transaction") and "fiduciary duty". Neither is relevant here.[36]

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[36] Reliance it appears, has developed an additional doctrine uniquely its own: the "consultation with counsel to ascertain the law" rule. Reliance makes the extraordinary suggestion that Emerson, because it had been advised by counsel of its legal rights with respect to §16(b), and because it thereafter made a sale fitting squarely within the exemption provision, somehow engaged in tainted conduct. Liability would *not* attach, under Reliance's theory, and the exemption *would* have applied so as to protect Emerson, had it reached the same result inadvertently. This proposition—that Emerson cannot retain the benefit of the exemption provision of §16(b) simply because it consulted and acted upon the advice of counsel—is shocking to say the least.

The courts in applying §16(b) have recognized that an insider may legally structure his affairs to avoid liability. The holder is "deemed capable of structuring his dealings to avoid any possibility of taint . . ." *Bershad* v. *McDonough*, 428 F.2d 693, 696 (7th Cir. 1970). *See also Adler* v. *Klawans*, 267 F.2d 840, 845 (2d Cir. 1959); *Stella* v. *Graham-Paige Motors Corp.*, 104 F.Supp. 957, 960 (S.D.N.Y. 1952).

As the Eighth Circuit noted, tax planning by taxpayers is a forceful analogy (A. 180). A taxpayer, knowing that he has a certain amount of money to invest, can elect to invest in tax ex-

Ignoring the fact that, for purposes of §16(b), a "transaction" is comprised of *a* purchase and *a* sale, *see* pp. 21-22 *supra,* Reliance argues that the whole of Emerson's experience in Dodge stock constitute one "transaction", the substance of which must prevail over form (Reliance Brief, pp. 23-4).

It is only in sham transactions that planned avoidance of §16(b) liability will be denied effect by the doctrine of "substance over form." *See, e.g., Bershad* v. *McDonough*, 428 F.2d 693, 697 (7th Cir. 1970); neither of Emerson's two distinct, open, independent and actual sales was a sham. At the time of Emerson's first sale, no second sale was waiting in the wings for the remaining shares. For all Emerson knew, it might have ended up with Reliance shares pursuant to the merger. Both Reliance and Goldman, Sachs & Co. acted as independent third parties in two *bona fide* and arms-length sales at separately negotiated prices. Indeed, the negotiations for the second sale were initiated by Reliance itself the day after Emerson's sale to Goldman, Sachs & Co. was reported.

The *sole* support which Reliance can cite for its theory that Emerson should be held liable on its second sale under "substance over form" principles is the opinion of the district court in this very case (Reliance Brief, pp. 23-25). Yet it was on this precise point that the Eighth

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(Footnote continued)

empt property and escape tax altogether. He can elect to invest in property yielding depreciation deductions or depletion allowances. He may average fluctuating yearly income. He can even refuse to invest his money. Each of these alternatives results in some measure of tax avoidance. Each is completely legal. As the Court said in *Gregory* v. *Helvering*, 293 U.S. 465, at 469 (1935):

> "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."

Circuit overruled the district court, correctly holding:

> " . . . as a matter of law that *intent as such to avoid loss of* realized profits by engaging in two independent sales not legally tied to each other and made at different times to different buyers such as these described above, *does not result in treating the two sales as one sale of the entire stock held, nor as one continuous transaction. . . .* " (A. 181-82) (Emphasis added.)

Narrowing its "substance over form" argument, Reliance invokes the "step-transaction" refinement developed for analysis of the tax consequences of multi-step transactions. Reliance Brief, pp. 25-27. Instead of addressing the plain language of the statutory provision involved here, Reliance relies upon three tax-free reorganization cases[37] and two depreciation deduction cases[38] in which the statutes and the transactions involved were demonstrably unrelated to the "sale" language of §16(b).[39]

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[37] *Commissioner* v. *Gordon*, 391 U.S. 83 (1968); *King Enterprises, Inc.* v. *United States*, 418 F.2d 511 (Ct. Cl. 1969); *Anheuser-Busch, Inc.* v. *Helvering*, 40 B.T.A. 1100 (1939), *aff'd*, 115 F.2d 662 (8th Cir. 1940), *cert. denied*, 312 U.S. 699 (19441).

[38] *United States* v. *General Geophysical Co.*, 296 F.2d 86 (5th Cir. 1961), *cert. denied*, 369 U.S. 849 (1962); *American Bantam Car Co.* v. *Commissioner*, 11 T.C. 397 (1948), *aff'd*, 177 F.2d 513 (3d Cir., 1949), *cert. denied*, 339 U.S. 920 (1950).

[39] "[T]he courts, using the step transaction doctrine, must wrestle with *a particular statutory description*. Some transactions described by the Code almost always involve many individual events. Examples abound in the various reorganization provisions. These are normally complex transactions, requiring many individual events. Thus, when deciding whether several steps constitute integral parts of a single reorganization transaction, courts may quite willingly accept a rather loose or tenuous nexus among them as enough cement

Although Reliance asserts that the "step transaction" doctrine is "well established" in federal securities law, Reliance Brief, page 26, it cites no authority for that statement with respect to the Exchange Act, which is involved here. The three cases it does cite, all arising under the Securities Act of 1933, relate to the "step transaction" doctrine only, as Reliance concedes, in the very broadest sense; in fact, each turned on sham or fraud,[40] and none is pertinent to the facts of the case at

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(Footnote continued)

to bind them together. *But when a court is faced with determining whether a corporation has made a 'distribution' or whether a 'sale' has occurred, it may be quite reluctant to combine several steps into one, because the statutory term with which it is dealing is normally thought of as involving a single event.*" Hobbet, *The Step Transaction Doctrine and Its Effect on Corporate Transactions*, Proceedings of the Nineteenth Annual Tulane Tax Institute 102 at 105 (H. Fuller ed. 1970). (Emphasis added.)

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[40] In *SEC* v. *Micro-Moisture Controls, Inc.*, 148 F.Supp. 558, 562 (S.D.N.Y. 1957) *aff'd sub nom. SEC* v. *Culpepper*, 270 F.2d 241 (2d Cir. 1959), the court found that the defendants, acting in concert, were in common control with or under the control of the issuer, were therefore "an issuer", and were thus not entitled to an exemption under Rule 133. In *In re Great Sweet Grass Oils, Ltd., et al.*, 37 S.E.C. Reports 683 (1957) *aff'd*, 256 F.2d 893 (D.C. Cir. 1958), the Commission found massive "boiler room" fraud, false and misleading reports to the SEC, and repeated flagrant violations of several sections of the 1933 Act. In *In re The Crowell-Collier Publishing Co.*, Securities Act Release No. 3825, Exchange Act Release No. 5562 (1957), [1957-1961 Transfer Binder] CCH Fed. Sec.L.Rep. ¶76,539, the Commission found that a purported 'private offering' was in fact carried out with 'investment letters' which falsely represented that the 'investors' were purchasing the securities solely for investment with no present intent of further distribution.

bar. None was concerned with sales, concededly present here and so found by both courts below, which were *bona fide,* independent, to completely unrelated purchasers as a result of separate, arms-length negotiations.

There is no indication that Emerson, when its first sale of Dodge stock was completed, had any plan whatsoever—let alone a "binding commitment"—to sell its remaining Dodge stock to anyone. *See Commissioner* v. *Gordon,* 391 U.S. 83, 96-97 (1968). Emerson either was or was not a less-than-10% owner of Dodge *when the first sale was concluded.* As far as Emerson was concerned, it was "little more than a fortuity" (391 U.S. at 97) that Reliance subsequently initiated negotiations for purchase of the shares still held by Emerson. This Court should not, by straining the "step transaction" doctrine beyond all prior bounds, "hold that the essential character [of Emerson's first sale, and its §16(b) implications] . . . should remain not only undeterminable but unfixed for an indefinite and unlimited period in the future, awaiting events that might or might not happen." 391 U.S. at 96.

As a final "theory of liability", Reliance, citing Chief Judge Cardozo's familiar dictum on fiduciary duty from *Meinhard* v. *Salmon,* 249 N.Y. 458, 164 N.E. 545, 546 (1928), argues that Emerson should be held on the second sale so that the "statutory fiduciary" standard of §16(b) will be maintained (Reliance Brief, pp. 28-29).

The cited standard is irrelevant. The question is not *what* the proper fiduciary standard is, but rather *who* is a fiduciary. Reliance at bottom is saying that 'Emerson was a fiduciary *because* it was covered by §16(b)."[41] That argu-

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[41] The fiduciary position thus created is an artificial creature of the statute. The only *true* fiduciary (such as an executor, conservator or trustee) in this case is the Dodge/Reliance management.

ment assumes the answer to the ultimate question in the case. Since Emerson by the terms of the statute was or was not covered by §16(b) at the time of its second sale, reference to the *duty* of a statutory fiduciary is pointless. As this Court said in *Blau* v. *Lehman Brothers,* 368 U.S. 403 at 409 (1962):

> "The language of §16 does not purport to impose its extraordinary liability on any 'person,' *'fiduciary' or not,* unless he or it is a 'director,' 'officer' or 'beneficial owner' of more than 10 percentum of any class of any equity security . . . . " (Emphasis added.)

At the time of the second sale Emerson was not an owner "of more than 10 per centum of" Dodge shares; it was therefore not a §16(b) fiduciary.

Contrary to Reliance's purported fears (Reliance Brief, page 29), the decision of the Court of Appeals will not allow "§16(b) fiduciaries" to make and keep profits by manipulating the form of their transactions. If they are indeed statutory fiduciaries, it will be solely because they are covered by the statute, and their profits will be fully recoverable; if they may keep their profits, it will be because they are exempt from §16(b) and, necessarily, are *not* "§16(b) fiduciaries." If they are not statutory fiduciaries under §16(b), but engage in insider overreaching or wrongdoing, they can be reached under §10(b) and Rule 10b-5.

As with its others, Reliance's final argument is without merit.

CONCLUSION

For the reasons and on the authorities set forth above, the judgment of the United States Court of Appeals for the Eighth Circuit should be affirmed.

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